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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1942.

No. 378

FRED PORTER, by His Executors, et al.,
Petitioners,

vs.

BARCLAY COOKE and ROBERT BARBOUR COOKE, as Executors of the Estate of WALTER E. COOKE, Deceased, et al.

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Fifth Circuit.

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To the United States Circuit Court of Appeals for the Fifth Circuit.

Fred Porter, by his executors, etc., et al., and on behalf of themselves as members of a joint enterprise and on behalf of all other members of the joint enterprise, pray that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit which sustained the judgment of the District Court for the Western District of Louisiana dismissing petitioners' suit to establish the interests of the members of a joint enterprise in certain oil properties and the income and proceeds thereof, and requesting the appointment of a receiver and the liquidation of the enterprise and distribution of its assets.

OPINIONS BELOW.

The opinion in the court below is reported in 127 Fed. (2) 853. The two opinions of the District Court are printed in volume 1, page 197 of the record, and volume 1, page 341. An earlier opinion of the District Court dismissing petitioners' bill is reported in 58 Fed. (2) 1033, and the opinion of the court below reversing the order of dismissal is reported in 63 Fed. (2) 637. Relevant portions of the Master's report are printed in volume 1, pp. 241-328.

A petition for rehearing was denied by the court below without opinion.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on May 1, 1942; a petition for rehearing was denied June 5, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code.

QUESTIONS PRESENTED.

The principal questions presented by the judgment of the court below are:

1. The extent to which one who voluntarily unites his capital with the capital of others for the purpose of exploring for oil and minerals under contracts providing for the distribution of contemplated profits and a continuing ownership of the properties of the enterprise in accordance with a plan of distribution set out in the contracts is disabled thereafter from acquiring, without the knowledge and consent of the other contributors, the properties of the enterprise and exploiting the same for his personal profit to the exclusion of the other contributors.

2. The extent of the fiduciary duty and the liability to account for any violation thereof with which a member of

such an enterprise is charged if he enters into an agreement with the managing trustee of the enterprise to share such profits as the trustee might derive as managing trustee and thereafter through such managing trustee takes an active part in directing the affairs and operation of the enterprise.

3. The extent to which anyone who enters into an agreement with the managing trustee of a trust estate to share such profits as the trustee might derive as managing trustee and who thereafter through such managing trustee takes an active part in directing affairs and operation of the trust estate becomes thereby a fiduciary to the beneficiaries of the trust estate and liable to such beneficiaries for any violation of the trust.

4. The extent to which an employee of such an enterprise who is placed in charge of its exploratory oil drilling operations is barred from making use of confidential information acquired during such employment for his personal profit to the exclusion of the members of the enterprise.

5. The extent to which such an employee is liable to the members of such enterprise for withholding from them information obtained in the course of his employment by the enterprise, and using that information for his own profit to the exclusion of the members of the enterprise.

6. The extent to which a member of such an enterprise who confederates with such an employee with knowledge of his status becomes bound jointly and severally with him to account and restore to the enterprise and its members all the fruits and profits derived by him as a result of exploiting confidential information so acquired.

7. The extent to which anyone who confederates with such an employee with knowledge of his status becomes

bound to account and restore to the enterprise and its members the fruits and profits derived by him as a result of exploiting the confidential information so acquired.

8. The extent to which the disabilities circumscribing a fiduciary in his dealings with trust property are relaxed if the trust estate is in financial distress.

9. Whether, by virtue of the recording statutes of the State of Louisiana, leaseholds for oil and mineral development on land located in Louisiana belonging to a joint enterprise but recorded in the name of the managing trustee of the enterprise may be transferred without the knowledge or consent of the members of the enterprise free and clear of the equities of such members, to one who has knowledge of such equities and/or who himself is a member of the enterprise.

10. Whether a transfer of trust property by the managing trustee to a beneficiary of the trust, or to one who has knowledge of the trust, which is induced by threat of criminal prosecution, is voidable at the instance of the beneficiaries of the trust.

11. Whether the knowledge by beneficiaries of a trust of a transfer by the trustee of trust property without knowledge of the identity of the transferee or the terms or circumstances of the transfer constitutes ratification by the beneficiaries of the transfer of such trust property, or whether such transfer is voidable at the option of the beneficiaries.

12. The extent to which costs should be assessed against the beneficiaries of a trust estate who bring suit against the trustee and others to compel an accounting for an admitted violation of the trust and an improper refusal to account.

STATUTES INVOLVED.

The relevant provisions of the statutes involved are set forth in the Appendix, infra, page 49.

STATEMENT.

This is a class suit commenced in 1931 in the District Court of the United States of the Western District of Louisiana by members of a joint enterprise engaged in exploration for oil and minerals in Sabine Parish, in Western Louisiana, against the managing trustee of the enterprise (Emlet), a former employee of the enterprise (Gay), and one of the members of the enterprise (Cooke), to recover and conserve as a trust fund for the benefit of all the members of the joint enterprise the assets and profits of certain oil operations and for the appointment of a receiver and an accounting by Emlet, Gay and Cooke of assets and property of the enterprise converted or wasted. The joint enterprise was founded upon certain written subscription contracts, pursuant to which Cooke, the petitioners and others in excess of five hundred, had contributed to an enterprise fund for the purpose of exploring or wildcatting for oils and minerals. These contracts, while varying somewhat in form, all provided, in substance, that the members should share in the earnings of the operations by having returned to them the full amount of their contribution, together with 100 per cent profit, the remaining assets of the enterprise to be transferred by the managing trustee (Emlet) to a corporation (Emlet & Company, Inc.[1]), in which shares were to be issued to the

[1] This corporation was organized under the laws of the State of Delaware, but never actually engaged in business. Its charter was suspended, but later, at the instance of members of the joint enterprise, reinstated. Its liquidators appointed under the laws of Delaware by the Court of its domicile will intervene in this suit at the proper time. It never had any accumulated capital and its sole asset consisted of its right to receive, upon the termination of the trust imposed upon Emlet, all the assets of the enterprise remaining after the return to the contributors of their contributions with 100 per cent profit.

members in certain proportions based upon the amount of their contributions. A typical membership contract is set forth in the Appendix, infra, pages 49-52.

Members of the enterprise were solicited by circulars and correspondence which urged them to send monthly or other periodic payments to Emlet with the assurance that each payment would be credited to them under the membership contract plan above described (R. 909-1035).

Cooke was the largest individual contributing member in the enterprise, he having contributed in cash directly under the membership contract a total of $28,000.00 (R. 304), and having had issued to him 1,185 shares of Emlet & Company, Inc. (R. 215).

In addition Cooke entered into a secret agreement with Emlet for an equal share in such profits as Emlet might personally make out of the enterprise as managing trustee or otherwise, in connection with which he advanced other sums through Emlet which were classified by the Master as loans having priority over membership demands (R. 287).

The office of the enterprise was located in St. Louis, Missouri. The membership contracts had a St. Louis, Missouri, date line. They were entered into by citizens of various states. Funds of the enterprise were generally cleared in St. Louis. Emlet, a resident of St. Louis, was to make the distribution of profits under the contracts. It was not contemplated that the enterprise would have any accumulated capital prior to discovering oil, all the contributions being expended as rapidly as received in carrying on the explorations, and it was not contemplated that the expenditure of enterprise funds for its explorations would be limited to any particular state. At the institution of the membership contract plan it was contemplated that the exploration for oil would be undertaken in Texas and Oklahoma, and it was not until some time later that

Louisiana, where the profitable production was eventually achieved, was entered.

The allegations which formed the basis of petitioners' suit in the District Court were that defendant Cooke was a member of a joint enterprise with petitioners, and, with the aid of defendant Gay, who was a confidential employee of the enterprise in charge of its exploratory field operations, had conspired with or coerced defendant Emlet, the managing trustee of the enterprise, to sign a contract on February 9, 1928, under which Emlet transferred to Cooke substantially all the assets of the enterprise, including leaseholds and drilling rights and all the well equipment and machinery belonging to the business; that thereafter, pursuant to a plan to assure themselves all the enterprise and its profits, Cooke and Gay by the device of lapsing leases and reacquiring the same or substituted or increased acreage in their own name, and by other devices secured title to all the drilling rights of the enterprise; had discovered oil thereon and subsequently sold a portion thereof and the oil produced therefrom for a large sum of money, and had refused to account for the proceeds to the other members of the enterprise. The Standard Oil Company of Louisiana was joined as being in possession of the proceeds of enterprise oils purchased by it from Cooke and Gay with notice. The prayer was for a decree establishing title; for a full accounting of the assets and profits; for a judgment for any waste or deficiency; liquidation of the assets, and distribution thereof to the several members of the enterprise; and as an incident the appointment of a receiver and for an injunction and general relief (R. 85-110).

Defendant Cooke was not a resident within the district in which the suit was commenced. Service upon him was effected pursuant to Section 57 of the Judicial Code. Upon motion by Cooke to quash the service and dismiss the bill of complaint, the District Court held that the suit was not

one asserting an interest or lien in property, and, therefore, Cooke could not be brought into the court under Section 57 of the Judicial Code. As to Gay and the other defendants, the District Judge held the bill of complaint failed to state a cause of action and entered a decree dismissing the suit against all the defendants (R. 67). On appeal to the Circuit Court of Appeals for the Fifth Circuit, the District Court was reversed (63 Fed. [2d] 637), the Circuit Court of Appeals stating:

> "Allegations made show that the individual appellees (defendants) having been furnished moneys by the appellants for investment in property in the benefits of the ownership of which the appellants were to share, and moneys so furnished having been used by the individual appellees in acquiring properties referred to, a trust resulted in favor of appellants."

Thereafter, Cooke and Gay filed answers denying petitioners' allegation of fraud and imposition, denying that they were members of any joint enterprise with petitioners, and denying petitioners' claims to interest in the property sued for, particularly in what was referred to as the Loring leases on which the profitable oil production had been obtained (R. 164, 184). After a trial covering a period of several months, which entailed the introduction of a great mass of evidence with more than 1,000 exhibits, 2,000 pages of testimony, and several hundred pages of depositions (R. 243), the District Court entered judgment in favor of petitioners (R. 196). In his opinion the District Judge stated:

> "Without deeming it necessary to detail further the great mass of evidence in this record tending to show that Cooke was familiar with what was going on and that other persons were being solicited and drawn in proportionately on substantially the same basis as himself, I think what has been stated and quoted

above suffices to show that he did have this knowledge and that Emlet was acting in such manner as to necessarily create a relation of trust in which they were all, including Cooke, interested on similar terms, the chief difference being in the much larger amount of money which was furnished by the latter. The money furnished under whatever form of agreement was used, was for the common purpose of acquiring leases and mineral rights and drilling the properties for oil and gas. It is perfectly clear from the above that this was true both as to the Texas properties, the properties of the Keystone and other leases in Sabine Parish, and nothing appears to justify any other conclusion as to all of the operations of Emlet. The way he explained it was that when an undertaking was 'washed up,' that is, its possibilities, prospects and assets were exhausted, he attempted to carry his investors over into the next successive venture so they could recoup what they had lost in the others, and this included Cooke" (R. 219).

* * * * * * *

"Gay's status in the matter was that at the time negotiations were commenced with the Keystone he was employed by or connected with that concern, and after Emlet made his contract with it, Gay did what he could to assist in inducing stockholders or investors in Keystone to put up more money for use by Emlet in his operations under the contract which he made with that company. When Emlet took over the equipment and began drilling in Sabine Parish, Gay was made manager of field operations, was paid a salary and his arrangement with the Keystone to receive 1,000 acres of leases was continued. He continued this relationship towards the enterprise some four years, with Emlet doing the promoting, raising the money from Cooke and others, mainly from Cooke, but toward the end of the time when Emlet and Cooke dissolved their arrangement and divided the properties, Gay, together with another representative sent into the field by Cooke, began confidential communications

with the latter, which served to inspire confidence in Gay by Cooke, so that when the latter finally took over the enterprise from Emlet, Gay was taken over also as field manager, and given or promised a substantial interest in the result by Cooke, which was received when oil in paying quantities was eventually found (R. 220).

"During the approximately four years of operations in the Sabine field by Emlet, several wells were drilled in different localities, but none produced oil in paying quantities before he retired and Cooke and Gay took charge. However, the explorations had served the purpose of aiding materially in the later operations which finally resulted in the discovery of an oil field and the disposition of it by Cooke for a very large sum of money" (R. 221).

* * * * * * *

"The Court of Appeals for this circuit has already settled the issue of a lien upon the properties, acquired in the names of any of the defendants with money furnished by the complainants or others for investment therein, and 'in the benefits of the ownership in which' they were to share. I think it clear that all who furnished him with money did so with the definite understanding that they were to share in the benefits of the enterprise by having returned to them the amount of their investment, with one hundred per cent profit from the discovery of oil or other minerals which made this possible, and further, that they were to share in the profits of Emlet's promotions after the payment of said sums, through his conveyance of the remainder of the properties to the corporation of Emlet & Company, in which said investors were either given or promised stock proportionate to their said investments. In other words, it was clearly an undertaking where all were putting up their money in an effort to discover oil or other minerals and with the hope of big profits, which were to be shared according to the amount each contributed to the whole. Undoubtedly, had this been a single transaction, wherein

> Emlet was furnished money to buy a single piece of property for exploration for oil, on the same conditions under which he took the money from these complainants and others, and he had taken the title in his own name, drilled and discovered oil and failed to comply with the promise or understanding to reimburse the investors with 100% profits and to convey the property to the corporation, under the view expressed by the Court of Appeals, the investors would have acquired an equitable lien on such property and Emlet could have been compelled to account to them for their shares. Since Cooke was aware of this situation, having gone into the enterprise on the same terms himself, the relation which he bore to the undertaking was such that neither he, Emlet or Gay, nor anyone else so situated, could become the owner of the trust estate in a manner to relieve him from responsibility to his associates'' (R. 226).

The District Judge then appointed a special master to hear and determine the rights and claims of the several parties who had participated in the enterprise and to take and state an account as between them with authority to find the facts and to make report thereof as well as recommendations as to the legal rights of all concerned (R. 229). The Court also appointed a receiver to take charge of the property and assets of the trust estate pending a final determination and disposition of the rights of the parties (R. 240).

The Master heard and reported on the account of Cooke and Gay with respect to their oil operations in Sabine Parish and heard and reported on the claims of 517 persons, the accounting requiring approximately two years and entailing a cost of over $26,000.00, including the fees of the Receiver and the Master. Cooke, as ordered by the Court, filed an accounting with the Master. Later Cooke appeared by special plea and reiterated his claim that any relationship of trustee which might have been created

under and by virtue of his contract with Emlet of February 9, 1928, and the assignments made pursuant thereto or subsequent thereto, had been fully discharged by the completion of said contract and laid claim to the substitute leases secured by him from the landlord and the proceeds thereof as his independent property and asserted that he was under no further responsibility in the premises; and in the alternative in the event that it should be held that the obligation as trustee continued subsequent to September 1, 1928, and that he should be held to account for any receipts thereafter, then such obligation and accounting should be limited and restricted to the precise property acquired by him under the contract with Emlet of February 9, 1928, and the assignments made pursuant thereto (R. 247). Claiming that the Loring leases acquired from Emlet had lapsed and been reacquired by him independent of the contract with Emlet, his plea in effect sought to limit the accounting to the income and profits from the Blue Lake leases, which he still held by the original grant from Emlet.

The parties and Master agreed that the Master might first determine tentatively the scope and extent of the operations which should be brought into the accounting, it being understood that the profits secured by Cooke were obtained largely from certain Loring operation, the leases constituting the same having been sold by Cooke and Gay, and that the operations on the Blue Lake leases would not be likely to show any large profits, and that if the Loring operation was found not to be within the scope of the joint enterprise the accounting might be confined to the Blue Lake operations still possessed by Cooke, greatly limiting the accounting.

The various leases under which the operations were conducted for the discovery and production of oil prior to and subsequent to the contract of February 9, 1928, were all in

Sabine Parish and fell roughly into three groups, known as the Blue Lake leases; the Loring leases, and the Long Bell leases.

The Blue Lake and Loring leases were contiguous and some twelve wells had been drilled thereon by Emlet. The Long Bell leases were in two tracts several miles away from Emlet's holdings and were acquired by Cooke from a landlord with whom Emlet had never had any dealings. The Long Bell leases never showed any profit and the controversy with respect to them was largely over the question as to whether Cooke's expenses in drilling them should be allowed as a beneficial expenditure. The Master finally allowed Cooke credit for the Long Bell expenditures made prior to the institution of the present suit (R. 265).

After taking evidence and hearing the argument the Master found that the District Court intended to include, and did include, the Loring operations in the properties forming a part of the enterprise and affected by its decree, and, in addition, the Master himself found as a fact that these operations were properly to be included within the scope of the enterprise operations and subject to the accounting (R. 267).

In his report the Master included a specific finding that all the leases known as the Blue Lake and Loring leases were actually a part of the enterprise property or included within the scope of the enterprise, and as to such property and the profits and income therefrom Cooke and Gay occupied the position of trustees ex maleficio, as a result of their confederating to violate the obligations of their respective fiduciary relationship to the other members of the enterprise, and as such trustees ex maleficio were accountable jointly and severally and obliged to restore to the Receiver all the profits and increment therefrom under the rule declared by this Court in the case of Jackson v. Smith, 254 U. S. 586 (R. 296).

The Master then took and stated the account of Cooke and Gay as trustees ex maleficio and found that Cooke and Gay, as such, were indebted to the Receiver of the enterprise in the gross sum of $1,898,269.03, less beneficial expenditures aggregating $713,030.67 (R. 280), or a net indebtedness of $1,185,238.36, with interest thereon, calculated to the first day of December, 1937, in the sum of $458,527.27, together with interest thereafter to accrue on the principal sum at the rate of 5 per cent per annum until paid (R. 282), against which they should be allowed a contingent credit for $143,748.66, or so much thereof as might be paid to the Receiver by the Standard Oil Company of Louisiana and representing moneys paid to the other respondents by the Standard Oil Company after the institution of the suit under the security of bonds executed by Cooke and Gay (R. 282). As to the Standard Oil Company of Louisiana, the Master found that the company was indebted to the Receiver in the total sum of $194,122.49, $143,748.60 thereof being the moneys above referred to and $50,373.83 thereof being the proceeds of oils and royalties received and still retained by it (R. 291).

The Master also found the amount to which each contributor, including Cooke, was entitled to receive from the enterprise profits as members of the enterprise directly from the trustee Emlet and prior to delivering the residue of the enterprise properties to the corporation Emlet & Company, Inc., and the Master also found and stated the amount which Cooke and other investors had contributed to the enterprise in the nature of loans rather than contributions to capital under the membership subscriptions in the nature of stock participation.

The Master failed to report the disposition of the balance of the sums found due from Cooke and Gay and the Standard Oil Company, which, under the terms of the membership contracts, should have been transferred by Emlet

to Emlet & Company, Inc., for the indirect benefit of the members, its stockholders, on the ground he found no express mandate from the Court and no justification in the record to authorize the payment of the money due to the then dissolved corporation.[1] The Master reported that with all the facts before it the District Court might determine the disposition of the residue or that the matter might be rereferred to the Master for report and recommendation by him (R. 223).

The petitioners and the defendants below respectively filed numerous exceptions to the report of the Master. The District Court did not rule specifically on any of the exceptions, but rendered an opinion on the whole case and dismissed the suit and taxed the costs against the funds then in the hands of the Receiver. Motions for a new trial were filed and urged by both sides, which were overruled, and the decree entered.

In the Court's opinion considerable emphasis was placed upon the fact that the large production on the Loring operations from which Cooke and Gay reaped substantially all their profits was not upon lands which were transferred by Emlet directly to Cooke pursuant to the contract of February 9, 1928.

The undisputed facts were briefly as follows:

Under the contract of February 9, 1928, Emlet transferred to Cooke all the equipment and chattels, including drilling rigs, etc., of the enterprise, and about 12,000 acres of oil leases or drilling rights, retaining at that time about 4,000 acres scattered throughout the area. By letters passing between Cooke and Gay it was developed that within some four months thereafter Cooke and Gay, for the purpose of divesting Emlet of the remaining acreage ("get him entirely out") (R. 1084), ostensibly permitted all the

[1] The charter had been suspended by the Delaware authorities for failure to pay the franchise tax.

leases in the Loring tract, approximating some 8,000 acres, to lapse, which had the effect of lapsing all the Loring leases acquired by Cooke from Emlet, together with all the acreage in that area which had been retained by Emlet in the partition between him and Cooke of February 9, 1928. But in connection with the ostensible lapse Cooke had an understanding with the landlord that when the leases had lapsed new leases would be executed by the landlord directly to Cooke for such acreage as he might desire. Pursuant to that arrangement Cooke secured from the landlord a new lease for the Loring acreage, which, in addition to the acreage previously transferred by Emlet to Cooke and the acreage retained by Emlet in the assignment of February 9th, included some 770 acres contiguous to and immediately north and east of the Emlet leases. On the 770 acres, and slightly more than a quarter of a mile north of the Emlet tract, Cooke and Gay brought in a gusher well and began drilling another well south of it, but on the old Emlet acreage. Before the second well was completed Cooke and Gay sold the new or substitute lease in its entirety to the Benedum Trees Oil Company of Pittsburgh, or its subsidiary, the Loring Oil Company, the sale of the said lease carrying with it the gusher well, and the well then being drilled on the Emlet tract, the named consideration for the whole lease being $3,000,000.00.

The circumstances under which the Emlet leases were ostensibly allowed to lapse and the new or substitute lease obtained is set forth in correspondence had between Cooke and Gay. In the Appendix at pages 53-54 are references to the record, where significant portions of the correspondence may be found.

In its opinion subsequent to the report of the Master the Court said that the Master had erroneously construed its prior opinion as holding that what Cooke took was "not solely" the "lands and their delineations and demarca-

tions," but "* * * the business of developing the same for oil or gas" (R. 347). The Court said (R. 348):

> "He (the Master) doubtless considered that since the object of the undertaking was the discovery of oil, gas and other minerals in paying quantities, when Cooke forced Emlet to transfer to him a substantial part of the leases, drilling equipment, etc., the leases might be likened to a stock of goods, the equipment to the fixtures and the information obtained over a period of some four years of drilling, to the good will or established trade of the commercial enterprise, and the taking of new leases to the purchase of a new stock in trade."

The Court then stated that the Master was "doubtless influenced by the statement of the Court in its previous opinion with reference to information gained as to possible geological trends in the field that could have guided Cooke and Gay in their subsequent operations, which finally resulted in the discovery of oil in the Loring section" (R. 348).

The precise statement referred to by the Court, as found in its former opinion, was as follows:

> "However, the explorations had served the purpose of aiding materially in the later operations, which finally resulted in the discovery of an oil field and the disposition of it by Cooke for a very large sum of money" (R. 221).

The former opinion of the District Court that the information acquired by Gay while a confidential employee in charge of the drilling operations for the enterprise **had** aided in the later discovery is fully established in the evidence by the confidential letter written by Gay to Cooke on December 19, 1927, while Gay was still in charge of drilling operations for the enterprise and while Cooke was securing from Emlet assignments of leases subsequently

confirmed in the agreement of February 9, 1928. Gay, then contemplating a confederacy with Cooke, and assuring Cooke of his loyalty to him (Comp. Exh. 180, R. 1069), wrote:

> "I have AN IDEA (sic). You see we want to play towards the northeast, there is where I showed you the lay of the land the day we went to Many.
>
> "* * * we have the best proposition I know of—the best chance in the world now to bring in a field. Our pioneering days are about over, we have about proven the field, we know it's there and we know that we have the working unit here that is pulling together and we have all we need in the way of knowledge of what has been done, the faults, the errors and other setbacks can now be used to advantage" (R. 1074).

The District Court's opinion proceeded:

> "However, in attempting to apply the principles of equity, by assimilating the situation here to a commercial enterprise, we must treat the matter as it actually was, not as an ideal conception, when a prosperous going concern, with plenty of capital and a solvent business existed. Following to its logical conclusion the attempted comparison, if, instead of an existing successful business, with a reasonable certain future, we had a situation where it was, under a fair consideration of all known factors and reasonable expectations, grossly insolvent, with no one else able or willing, notwithstanding continuous appeals, to put up any more money to save it from bankruptcy, and a single partner, stockholder or investor financially able and willing to take over a part of the business for his own account, had, as a consideration for the transfer by the managing partner or trustee, placed in charge by all the investors, assumed a large indebtedness, equally, perhaps, the present value of the assets so transferred; and, in addition, the said transferee had undertaken to expend considerable sums of money in an effort to increase, not only the value of the stock

transferred to him, but also that portion retained by the conventional trustee, we would have an entirely different picture" (R. 348).

* * * * * * *

"The mistake made by Cooke was in not forcing the issue through receivership and liquidation, instead of coercing Emlet. In that way he could have, in competition with his co-investor and the public, purchased all or a part of the assets. However, the course followed did not give to the matter any 'untouchable' aspect, or convert what was otherwise dross under any normal conception into gold. It simply imposed upon Cooke the duty of accounting to his associates for what he took and prohibited him from reaping any unjust profit therefrom" (R. 349).

The Court concluded that the accounting must be confined to what

"was actually taken over on February 9, 1928, at the value which it then possessed when tested by every reasonable consideration affecting it. I am further convinced that under any fair and reasonable basis that value did not exceed the indebtedness of the enterprise, which was assumed and subsequently paid by Cooke and that it was much less than the entire consideration, which included the drilling of wells in the Blue Lake section. Equity requires a constructive trustee or trustee ex maleficio to restore to those holding any beneficial interest in the property or estate coming under his control, all that he has wrongfully taken and to account for the fruits of his inequitable conduct; but it does not compel him to surrender that which is the product of his own independent labor and investment. There must be a casual connection or proximate cause, so to speak, to render him liable. **Rea v. Rea**, 285 Pac. 573, 97 Calif. 264; **Irving v. Deutsch**, 2nd Fed. Supp. 971; C. J., Vol. 65, verbo, 'Trusts,' Sec. 215, pp. 454 et seq., and authorities therein cited.

> "My view is that, when the equities are balanced, Cooke and Gay do not owe the complainants and others connected with the joint enterprise anything; nor do I feel that the property and funds taken into the hands of the receiver are affected with any lien or claim in favor of the complainants" (R. 352).
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> * * * * * * *
>
> * * * "In view of the circumstances, however, and especially the failure of Cooke to resort to judicial procedure for the settlement of his relations with Emlet and the other investors, instead of adopting the method which he used, I think the costs of this proceeding should be borne by the estate drawn into the hands of the receiver" (R. 353).

The Court then ordered the entire proceeding dismissed and the costs taxed against the properties in the hands of the Receiver (R. 353).

Petitioners filed a motion for rehearing and new trial, which was overruled. Petitioners appealed to the court below from the District Court's dismissal of the suit, and Cooke and Gay appealed from so much of the judgment as taxed the estate with costs. The Standard Oil Company of Louisiana, while the appeal was pending, paid over the money being retained by it to Cooke and Gay and moved to dismiss the appeal as to it in the Court of Appeals, on the ground that the case as to it had become moot. The Court of Appeals overruled the Standard Oil Company's motion to dismiss but permitted it to refile the same on the final hearing.

The court below, without ruling or commenting on the Standard Oil Company's motion to dismiss, refiled at the hearing on the merits, by written opinion affirmed the District Court's order dismissing the cause on the merits, but, as to the imposition of costs, reversed the District Court and directed that the costs be assessed against petitioners on the ground that the facts as conceived by the court

below showed that the "receivership was instituted and property seized upon an unfounded claim" (loc. cit. page 859).

Subsequent to the judgment of the Court of Appeals the District Court entered an order taxing jointly and in solido against all the petitioners and all the claimants who appeared and filed a claim with the Master, except Cooke and Gay who also filed a claim, all the costs of the suit, of the receivership, and of the accounting had between the enterprise and the respondents and the claims accounting, aggregating all told the sum of $26,578.35, and ordered execution therefor.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that Cooke was not a member of the joint enterprise with petitioners prior to February 9, 1928.

2. In failing to hold that the membership contracts entered into by Cooke and petitioners made them all members of a joint adventure.

3. In holding that Cooke was not a member of the enterprise, and did not bear a relationship to the other members analogous to that of a partner because he never intended to be a partner or to enter into that relationship, notwithstanding it was admitted that Cooke signed and contributed under the common membership subscription agreement; admitted he was bound thereby and did not plead in avoidance thereof any facts tending to show a mistake on his part or lack of free consent.

4. In holding that petitioners based their right to recover solely upon the theory that Cooke and Gay became joint adventurers with petitioners as the result of their acquisition of leases and property from Emlet pursuant to the contract of February 9, 1928, rather than upon the breach of the contractual obligations between the parties as joint adventurers and upon the breach of Gay's obligations as a confidential employee concurred in by Cooke, as well as upon the basis of Cooke's partnership agreement with Emlet.

5. In holding that petitioners, by permitting Emlet to take or hold title to the leaseholds of oil properties in the State of Louisiana and record the same in his own name, prevented themselves from asserting an interest in such leaseholds against Cooke and Gay, who purchased them from Emlet.

6. In failing to hold that Cooke was accountable to the members of the enterprise, not only for the physical properties acquired from Emlet pursuant to the contract of February 9, 1928, but also for the assets and profits of the business of the enterprise as thereafter conducted by Cooke and Gay.

7. In holding, contrary to the rulings of the highest court of the State of Louisiana, that Article 2266 of the Civil Code of Louisiana was applicable to the sale and recording of titles to leasehold interests, and that it bars petitioners from asserting an interest in the leaseholds transferred by Emlet to Cooke, contrary to the rule of decisions announced by the Supreme Court of Louisiana.

8. In holding that the petitioners were barred by Article 2266 from asserting title as against the defendants claiming under conveyance by Emlet, and in failing to rule that Cooke and his associate, Gay, were equitably barred from asserting and claiming the benefit of Article 2266 in any event for the purpose of perpetuating a fraud against the petitioners.

9. In failing to reverse on the merits the judgment of the District Court, which was based upon the erroneous conclusion of law that the Court should take into consideration the circumstances existing at the time of the assignment of leaseholds and property from Emlet to Cooke as bearing upon the equities of the petitioners, and that it could weigh and balance purported equities of Cooke and Gay as trustees ex maleficio against the equities of petitioners and other members of the enterprise, enter into a calculation for the purpose of determining whether the consideration for the transfer was adequate and disregarding the fiduciary relationship growing out of the contractual relations between the parties, confirm the transfer upon concluding that the consideration paid was ade-

quate and represented the fair value of the property under the particular circumstances as they appeared to be at the time said transfer was made.

10. In failing to apply to the facts as found by the Master and the District Court established principles of equity as pronounced by this Court, the several state courts, and the several Circuit Courts of Appeal, and particularly the principles of law announced in the cases cited infra.

11. In holding that the District Court erred in finding that Cooke coerced Emlet into signing the contract of February 9, 1928, and, in any event, in failing to hold that the contract of February 9, 1928, was voidable even if no coercion was employed, in view of the fact Cooke was a member of the enterprise and Gay a confidential employee and both knew Emlet was a trustee.

12. In holding that the assignment from Emlet to Cooke, pursuant to the contract of February 9, 1928, which was reported to petitioners, without declaring the name of the assignee and the terms of the assignment, constituted a concurrence in such assignment by petitioners.

13. In holding that the profits derived by Cooke and Gay from the Loring operations resulted from their individual efforts and expenditures and were not related to any property or interest which the petitioners had in the enterprise.

14. In holding, in accordance with the decision of the District Court in **Irving Trust Company v. Deutsch**, 2 Fed. Supp. 971, but contrary to the decision of the Circuit Court of Appeals for the Second Circuit, which overruled that case, 87 F. (2d) 1008, that where a trust estate is insolvent or in financial distress, the obligation of its trustees and fiduciaries to it and to the beneficiaries of the estate is relaxed in such manner that they may deal with the trust

assets free from the restrictions otherwise applicable to them as fiduciaries.

15. In failing to hold that Cooke, without regard to his relationship to petitioners as member of the joint enterprise, because he confederated with Gay, a confidential employee of the trust estate, to take the assets of the enterprise away from the petitioners or the managing trustee and to hold them in hostility to the trust estate and carry on the exploratory operations to the exclusion of the enterprise or in hostility to it, is liable jointly and severally with Gay for Gay's continuing breach of trust.

16. In failing to hold that Cooke and Gay converted information derived from their confidential relationship to the enterprise and utilized it to secure additional leases, whereon they made a profit, which in equity belonged to all members of the enterprise.

17. In failing to find that Cooke, notwithstanding that he was bound to the other members of the enterprise as a correlate by reason of his subscription under the membership contract plan, entered into a private and personal agreement with Emlet to share in Emlet's profits therefrom as managing trustee, which, taken in the light of Cooke's subsequent conduct, made him responsible to all the members of the joint enterprise to the same extent as was Emlet.

18. In failing to hold that without regard to Cooke's relationship to the enterprise as a member or fiduciary, and without regard to his liability resulting from confederating with Gay, a confidential employee of the enterprise, and without regard to his secret partnership agreement with Emlet, Cooke took the assignment of oil leases and property from Emlet pursuant to the February 9, 1928, contract with full knowledge of Emlet's trust relationship to petitioners, and therefore was accountable for

all the profits from the exploratory operations within the scope of the enterprise to the same extent Emlet would have been.

19. In holding, contrary to the decision of the District Court, that petitioners were not entitled at all events to an accounting from Cooke for the property acquired from Emlet pursuant to the contract of February 9, 1928.

20. In holding that the receivership was instituted and property was seized upon an unfounded claim, and therefore costs should be assessed against petitioners.

REASONS FOR GRANTING THE WRIT.

The decision of the court below raises questions of large public importance which should be decided by this Court. If permitted to stand, the holding of the court below will deter legitimate resort to judicial proceedings by small investors to obtain an accounting from a wrongdoing trustee. The questions of substantive law decided by the court below are of the gravest and most far-reaching character in the conduct of businesses by those who are entrusted with the handling of other people's money. The decision of the court below is in conflict with the decisions of the Supreme Court of Louisiana on the interpretation and construction of a Louisiana statute. The decision of the District Court, permitted to stand by the court below, conflicts with a decision of the Circuit Court of Appeals for the Second Circuit. The court below, on the erroneous assumption that it was following the findings of fact of the District Court and the Master, based its decision, in effect, upon its own findings of fact, which are contrary to the record evidence and constitute a reversal of the findings of fact of the District Court and of the Master, thereby so far departing from the proper course of judicial proceeding as to justify the exercise of the supervisory powers of this Court to prevent a miscarriage of justice.

1. The judgment of the court below as shown by its opinion is based upon an assumed set of facts so completely at variance with the record and the findings of the District Court and is so patently in error on the issues of law involved, as to call for the exercise of this Court's supervisory powers to prevent a miscarriage of justice.

(a) The court below stated: "It being established here both upon the findings and upon the facts the record discloses, that Cooke never intended to be and never was,

either a partner or a joint adventurer with the plaintiffs, the whole theory of recovery based upon the contention that he was falls to the ground." This statement is contrary to the undisputed evidence in the record, contrary to the findings of both the District Court and the Master, and contains an erroneous conclusion of law. It was never disputed that Cooke, who incidentally was a lawyer, signed a series of the membership contracts, and on the witness stand he admitted that he did sign them and considered himself bound thereby (R. 843).

(b) The court below stated that the District Court had found, contrary to petitioners' allegations, that petitioners were not associated with Cooke and Gay as partners or joint adventurers. Actually, what the District Court found was that Cooke *was* a member of the joint enterprise by reason of his having signed various membership contracts similar to those signed by other members of the joint enterprise. In the District Court's first opinion, following an extensive trial of the issues raised by petitioners' allegations, the District Judge set out the various membership contracts signed by Cooke and his contributions thereunder; found that Cooke was familiar with what was going on; that other persons were being solicited and being drawn in proportionately on substantially the same basis as Cooke; and that the evidence showed that Cooke did have this knowledge, saying:

> "* * * that Emlet was acting in such manner as to necessarily create a relation of trust in which they were all, including Cooke, interested on similar terms, the chief difference being in the much larger amount of money which was furnished by the latter (Cooke). The money furnished under whatever form of agreement was used for the common purpose of acquiring leases and mineral rights and drilling the properties for oil and gas" (R. 219).

In the District Court's second opinion (R. 341) it was again clearly stated that Cooke was a party to the joint enterprise of which the petitioners were also members. The following quotation leaves no possible room for doubt on this score:

> "In its opinion and decree making the reference, this Court did not attempt to say what should or should not be included as assets of the joint enterprise, but attempted to show that, generally speaking, the understanding had been one in which many people had advanced funds in the hope of reaping large profits through the discovery of oil or other minerals, and that while most of these investments were small compared to what respondent Walter E. Cooke had advanced, they had all been made substantially on the same basis, for which reason, according to the opinion of the Court of Appeals, they all acquired equitable liens upon the property and assets purchased with those funds, in whosoever's name acquired, and which followed them into the hands of Cooke and Emlet in their division by the agreement of February 9, 1928" (R. 342).

(c) The court below stated that "the theory on which the Master found for plaintiffs and which plaintiffs press here, that by acquiring leases and properties from Emlet, Cooke and Gay became joint adventurers under an obligation to continuously devote their time and money and talents to the service of the plaintiffs falls flat, with the finding that there never was, at any time, any agreement or understanding of any kind that Cooke and Gay, or either of them, were or would be joint adventurers with plaintiffs." At no time in this case did petitioners contend that the fiduciary relationship existing between Cooke and Gay and the other members of the enterprise came into existence for the first time as a result of the transfer of leases and properties from Emlet to Cooke. Petitioners, it is true,

claim that Cooke and Gay became trustees ex maleficio by acquiring the leases and enterprise property from Emlet, but always based their claim that Cooke was a co-adventurer with petitioners, and hence a fiduciary and barred from acquiring the enterprise assets in hostility to the petitioners, upon the undisputed fact that the so-called membership contracts which Cooke as well as the other members of the enterprise signed, were in all respects contracts of joint adventure, inasmuch as they contemplated contributions by numerous persons to a common fund for purposes of mutual profit.

(d) Under the law of the State of Missouri, which is the appropriate law which the court below should have applied to determine whether or not the membership contracts which Cooke and petitioners signed made them joint adventurers, there is no doubt about Cooke's status as a joint adventurer with petitioners.

Neville v. D'Oench, 327 Mo. 34, 34 S. W. (2) 491;
Denny v. Guyton, 327 Mo. 1030, 40 S. W. (2) 562;
Hobart Lee Tie Co. v. Grodsky, 329 Mo. 706, 46 S. W. (2) 859;
Creason v. Deatherage, 325 Mo. 661, 30 S. W. (2) 1;
Seehorn v. Hall, 130 Mo. 257;
Curry v. La Fon, 133 Mo. A. 163;
Cordia v. Connolly (Mo. A.), 261 S. W. 729 (not in State Reports);
Wetmore v. Crouch, 150 Mo. 671.

But the rule is not purely a local rule of the Missouri courts. It is a rule of the common law, recognized generally in all the state and federal courts.

Louisiana Cases:

Jansen v. Bellamore (Opinion by Judge Dawkins, nisi), 147 La. 900;
Byrd v. Meeks (App.), 156 So. 193 (affirmed 158 So. 70, not reported in state reports);

Tuck v. Atkins, 6 La. Ann. 110;
Ault & Wiborg v. Carbon Co., 181 La. 681;
J. F. Barnett Co. v. Ludean, 174 La. 803, 140 So. 849;
Clarke v. Hutchison, 175 La. 811;
American Nat. Bk. v. Oil Co., 156 La. 652;
Daily v. Uhalt, 169 La. 893;
Dulec v. Houma, 158 La. 804;
Ilg v. Regan, 166 La. 70.

Federal Cases:

Kimberley v. Charles D. Arms et al., 129 U. S. 512, 32 L. Ed. 764;
Reid v. Shaffer, 249 Fed. 553;
Foster v. Callaghan & Co., 248 Fed. 944;
In re McConnell, 197 Fed. 438;
Maas v. Lonstorf, 194 Fed. 577;
Dexter and Carpenter v. Houston, 20 Fed. (2) 647;
Trice et al. v. Comstock et al., 121 Fed. 620;
Humble Oil Co. v. Campbell (5 Cir.), 69 Fed. (2) 667.

Cooke and all the petitioners signed and contributed under the same or substantially the same type of membership contract, and hence all became parties to and bound by all the equitable implications thereof disabling them, within the scope and purpose of the enterprise, from competing with it or claiming in hostility to it except by the consent of all. [See cases supra and infra, (g).] The court below disregarded the membership contract which Cooke signed in reaching its conclusion that he was not a coadventurer with petitioners.

(e) As to the theory upon which the Master found that there existed a fiduciary relationship between Cooke and the other members of the enterprise, there is likewise no doubt that in the Master's opinion this relationship was created and continued by reason of the membership contracts. The Master's ruling was:

> "Briefly stated, the 2 for 1 contract constitutes the basis of the joint enterprise, and the rights of parties as members thereof and the shares of stock of Emlet & Co., Inc., constitutes the interest of the members in the assets" (R. 309).

The Master found that the membership contract plan was first presented to the members of the enterprise during the latter part of 1922, and that Cooke was the fifth subscriber thereto when he signed a contract for $100.00 (R. 311). The evidence shows that on December 5, 1924, Cooke signed his second contract for $3,375.00 (R. 805, 936); that on February 28, 1924, Cooke signed another membership contract for $30,000.00 (R. 957), and that on June 13, 1924, Cooke signed his last membership contract for $40,000.00, which incorporated all the moneys theretofore paid in by him under his previous subscription contracts (R. 957). The Master found that by taking over the enterprise leaseholds and property from Emlet, Cooke and Gay became trustees ex maleficio, but it is abundantly clear from the Master's report that the fiduciary relationship existing between Cooke and the other members of the enterprise already existed by reason of Cooke's participation in the membership contract plan (R. 275, 277, 280, 309).

As to Gay, the Master found that he was a confidential employee of the enterprise prior to the transfer of February 9, 1928, and it was by virtue of this fact that he stood in fiduciary relationship to the members of the enterprise. It was admitted that Gay was the field manager of the enterprise and a confidential employee, and it was found by the Court as well as by the Master that he cooperated with Cooke to secure for Cooke the leases and profits involved.

(f) The holding of the court below that the assignment of enterprise leaseholds and property from Emlet to Cooke was reported to and concurred in by petitioners is in utter

disregard of the finding of the District Court and the undisputed evidence. The District Court in its first opinion stated:

> "toward the last, he (Emlet) also informed his investors that an individual whose name he did not mention (undoubtedly meaning Cooke) had put up some $300,000.00 and an interest in the property had been or would be conveyed to this individual" (R. 225).

The evidence was undisputed that Cooke was fearful that Emlet would inform the others and, shortly after he acquired the leases of Emlet, he wrote his confederate, Gay:

> "I cannot help having great anxiety about Emlet and what he might do if you bring in a field."
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> • • • • • • •
>
> "One thing Emlet would try to do would be to notify all these stockholders who have been sending him money that I was his partner and they could look to me for a return of it" (Com. Ex. 198, R. 1096).

The respondents in their brief in the case below conceded in effect that Emlet did not advise the other members of the real facts. They stated, in substance, in their brief that Emlet in his circulars did not advise the members that Cooke was a member of the investment group, and said:

> "Emlet for quite some time was making every effort to conceal from the complainants, first, the existence of Cooke, and, second, the exact relationship which he had with Cooke" (Appellee's Brief below, p. 87; see Appendix infra, p. 53).

Without the knowledge that the assignment had been made to Cooke or that Cooke was a member or a confederate of Gay, an employee, as well as of all the circumstances surrounding such assignment, there could have

been no concurrence in or ratification or laches by the members of the enterprise in the assignment.

Mutual Life Insurance Co. v. Hilton-Green, 241 U. S. 613;
Bailey v. Glover, 88 U. S. 342;
Pence v. Langdon, 99 U. S. 578;
Tilden v. Barbour, 268 Fed. 587 (citing authorities);
Byrne v. Jones, 159 Fed. 321;
21 C. J. 214;
65 C. J. 867.

(g) The court below ignored completely petitioners' contentions, amply supported by the record, that, without regard to the relationship of Cooke to the petitioners as a member of the original coadventure, Cooke, because he confederated with Gay, a confidential employee of the enterprise, and took assets of the enterprise away from the managing trustee and held them in hostility to the other members of the enterprise, became liable jointly and severally with Gay for Gay's breach of trust, as declared in the following decisions:

Jackson v. Smith, 254 U. S. 586, 65 L. Ed. 418;
Triee et al. v. Comstock et al., 121 Fed. 620;
Iroquois Iron Co. v. Kruse, 241 Fed. 433;
Irving Trust Co. v. Deutsch, 73 Fed. (2) 121;
65 C. J. 487;
La. Rev. Civil Code 2324.

(h) The court below ignored completely petitioners' contention, amply supported by the record and by the District Court's findings (R. 221) and the Master's findings (R. 258, 264-266), that Cooke and Gay converted information derived from their confidential relationship to the enterprise and utilized it to secure additional leases whereon they made a profit which in equity belonged to all the members of the enterprise.

Jackson v. Smith, 250 U. S. 586, 65 L. Ed. 418;
Michoud v. Girod, 4 How. 503, 11 L. Ed. 1076;

Iroquois Iron Co. v. Kruse, 241 Fed. 433;
Foster v. Callaghan, 248 Fed. 944;
Trice v. Comstock, 121 Fed. 620;
Maas v. Lonsdorf, 194 Fed. 577;
Humble Oil Co. v. Campbell, 69 Fed. (2) 667;
Moto-Meter Co. v. National Co., 31 Fed. (2) 994;
Restatement of the Law—Restitution, Sections 200-201;
Restatement of the Law on Trusts, Section 170, pp. 431-439; Section 205, p. 569;
65 C. J. 436;
33 C. J. 851-2-6.

(i) The court below ignored completely petitioners' contention, amply supported by the record, that Cooke, notwithstanding the fact that he was bound to the other members of the enterprise as a correlate by reason of his subscriptions under a membership contract, entered into a private and personal agreement with Emlet, the managing trustee, whereby he became entitled to share in Emlet's profits as managing trustee, by reason of which action Cooke became jointly liable with Emlet in the promotion of the enterprise, particularly since he undertook to interfere in the control and management of the enterprise over a period of years. That agreement was entered into in Louisiana.

La. Revised Civil Code, Art. 2324;
Bryant v. Levy, 52 La. Ann. 1649, 28 So. 191;
Berenstein v. Commercial National Bank, 161 La. 38, 108 So. 117.

(j) The court below completely ignored petitioners' contention that without regard to Cooke's relationship to the enterprise as a member thereof; and without regard to his liability resulting from co-operating with Gay, a confidential employee of the enterprise; and without regard to Cooke's partnership agreement with Emlet, Cooke took by assignment from Emlet, pursuant to the contract of Feb-

ruary 9, 1928, the greater part of the leases and all the equipment held by Emlet as trustee for the enterprise and subsequently contrived to secure from Emlet directly or by the scheme of ostensibly lapsing leases, and immediately securing the execution of a new lease from the same landlord of the acreage that had been retained by Emlet after the contract and assignment of February 9, 1928, together with the Loring acreage previously assigned by Emlet so that on August 23, 1928, "Emlet was entirely out" (Comp. Ex. 346, Paragraph 5, R. 1222). All with full knowledge of Emlet's trust relationship to the petitioners, as a result of which Cooke became accountable for all the profits from the exploratory operations within the scope of the enterprise to the same extent as Emlet would have been.

Wormley v. Wormley, 8 Wheat. 421, 5 L. Ed. 651;
Duncan v. Jaudon, 82 U. S. 165, 21 L. Ed. 142;
U. S. v. Dunn, 268 U. S. 121, 69 L. Ed. 876;
U. S. F. & G. v. Ottawa Bank, 32 Fed. (2) 368;
25 C. J. 777, 886, 963, 986, 1076;
26 R. C. L. 1237, 1362;
Restatement of the Law of Trusts, Sections 285, 291.

It is respectfully submitted that had the foregoing issues been considered by the court below, the principles of law applicable thereto would have led to a different result from that reached. By ignoring issues duly and properly tendered by petitioners and basing its decision upon an assumed state of facts not borne out by the record, the court below reached a decision not responsive to the issues in the case. In so doing the error of the court below was graver than if it had merely disagreed with the Master's and the District Court's interpretation of the evidence. There is absolutely nothing in the record to support the view of the facts adopted by the court below. It is respectfully submitted that the court below, in flagrantly

disregarding the undisputed facts as established by the evidence and the findings of the Master and the District Judge, and in deciding the case without considering the important issues tendered by the evidence and the findings of the District Court, and in disregarding the Missouri law in determining the question of whether the membership contracts gave rise to a joint enterprise, so far departed from the normal and proper function of an appellate court as to call for the exercise of this Court's supervisory powers to prevent a miscarriage of justice.

2. The court below, in affirming the District Court, sustained a decision which is directly in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in the case of **Irving Trust Company v. Deutsch**, 87 F. (2nd) 1008. The District Court in the instant case held that Cooke was not liable to the other members of the enterprise for any of the profits received from the enterprise leaseholds and other property, which he had forced Emlet to transfer to him, because the price paid by Cooke for such leaseholds and other property was, in the opinion of the Court, equal to their value. In other words, he approached the case as though petitioners had elected to affirm the forced sale by Emlet to Cooke and had brought a suit for damages as for a conversion, when, in fact, petitioners by their suit had elected to disaffirm the unauthorized sale and had elected to recover the property and proceeds thereon to the same extent as they would have done had Emlet, the contractual trustee, undertaken in violation of his trust to divert the property and its proceeds to his own use. The election to affirm or disaffirm the transfer from Emlet to Cooke was with the beneficiaries and not with the Court.

It was the beneficiaries and not the Court who were vested with the power to elect to enforce the original contract of membership, or, on the contrary, to affirm the as-

signment and recover the reasonable value of the property taken as for a conversion. The petitioners, as members, did elect to enforce the original contract (see Original Petition, R. 21), and the numerous claimants who came in and filed their claims ratified the election of the petitioners on their behalf. The District Court undertook to deny to the petitioners the right to elect whether they would claim damages as for conversion, or, on the contrary, seek to recover under the terms of the original contract, and, having denied such right, the Court undertook to elect for them to recover their damages, and, concluding that by reason of the special circumstances and the fair value of the speculative property at the time of the conversion that the consideration was a fair equivalent, dismissed the petitioners' bill. He clearly exceeded his prerogatives.

Oliver v. Piatt, 3 How. 333, 11 L. Ed. 622;
Buffum v. Barceloux, 289 U. S. 227;
Michoud v. Girod, 4 How. 503;
Trice v. Comstock, 121 Fed. 620;
Maas v. Lonstorf, 194 Fed. 577;
Meinhard v. Salmon, 249 N. Y. 458;
Restatement Law of Trusts, Sections 337 (a), p. 1022; 340, pp. 1040, 1043, 1044; 342 (g), p. 1087; 253, p. 782;
33 C. J. 856, 849, 850.

It is unimportant that at the time the transfer from Emlet to Cooke took place the enterprise was hard pressed for funds. The District Court thought that this fact made a difference, as is shown from the following quotation:

> "Prior to February 9, 1928, there was nothing in Cooke's relation to the matter which obligated him, either legally or morally, to put any more money into the enterprise. Starting out, as did the others in the beginning, with a small investment, the salesmanship or enthusiasm of Emlet induced Cooke to come in and to keep increasing his investment until, at the end of

approximately six years, he had advanced in round figures about $300,000. But for this fact, the joint enterprise would have folded up or been 'washed up,' as Emlet expressed it, with respect to other schemes, long before February 9, 1928.

"The mistake made by Cooke was in not forcing the issue through receivership and liquidation instead of coercing Emlet. In that way he could have, in competition with his coinvestors and the public, purchased all or a part of the assets. However, the course followed did not give to the matter any 'untouchable' aspect, or convert what was otherwise dross under any normal conception, into gold. It simply imposed upon Cooke the duty of accounting to his associates for what he took and prohibited him from reaping any unjust profit therefrom" (R. 349).

The District Court then proceeded to consider whether the consideration paid by Cooke for the leaseholds and other properties taken was fair and reasonable under all the circumstances, and, concluding that it was, held that, balancing the equities as between Cooke and Gay and the petitioners, nothing further was due. The Court cited the case of **Irving Trust Company v. Deutsch**, 2 Fed. Supp. 971, in support of its conclusions. Although it was pointed out to the District Court that the decision of the District Court in the case of **Irving Trust Company v. Deutsch** on the very point upon which it was relied had been overruled by the Second Circuit (87 Fed. [2] 1008), and although this was pointed out again to the court below, neither the District Court nor the court below receded from their view that in cases involving a breach of loyalty and the acquisition of trust assets by a fiduciary, a court of equity might examine all the facts connected with such acquisition and calculate and determine the value of the property as of the date of the taking, with a view to determining the equitable character of the acquisition in the particular case, as they might appeal to the conscience

of the particular chancellor. The affirmance of the court below of the ruling of Judge Dawkins in this case is in direct conflict with the decision of the Circuit Court of Appeals for the Second Circuit, which overruled a similar ruling by Judge Woolsey in the case of **Irving Trust Company v. Deutsch.**

3. The decision of the court below is in conflict with all judicial precedent on an important question of substantive law which has a far-reaching effect, to wit, the extent to which one who is a member of a joint enterprise may acquire its assets by private convention with the trustee without the free consent of his correlates and enjoy profits directly or indirectly therefrom to the exclusion of other members. District Judge Dawkins, in this case, with the full concurrence of the court below, held Cooke responsible to conform to "the morals of the market place." But Cooke was a member of a joint enterprise, and hence bore a fiduciary or trust relationship to all the members of that enterprise.

> "Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty" (**Meinhard v. Salmon**, 249 N. Y. 458, 164 N. E. 545).
>
> "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behavior. As to this, there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the ruling of undivided loyalty by the 'disintegrating erosion' of particular exceptions (Wendt v. Fisher, 243 N. Y. 439, 444, 154 N. E. 303). Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this Court" (Justice Cardozo in **Meinhard v. Salmon**, supra).

The extent to which the rule of undivided loyalty between joint adventurers may be destroyed by the **disintegrating erosion** of particular exceptions is concretely presented by the instant case. The decision of the court below may well have a direct impact upon numerous business enterprises which are based upon a trust relationship between the several owners of the business as among themselves and also as to those who are selected or elect of their own accord to manage the business for their benefit. The type of joint enterprise involved in this case is representative of numerous and widespread business and promotional activities and practices. The ultimate decision in this case will constitute a precedent for the conduct and practices of trustees and fiduciaries in innumerable cases. There is little to distinguish the relationship between Emlet, Cooke and Gay and the other members of the enterprise from the relationship which exists in the usual type of corporate enterprise between stockholder, directors, and corporate employees. The standard of conduct imposed by the court below upon Emlet, Cooke and Gay in their dealings with the enterprise will certainly serve as a guide to others who are engaged in similar speculative promotional activities. Any relaxation of the strict rule of accountability and the strict rule of loyalty heretofore enjoined on persons dealing with other people's money corrodes away one of the most important cementing factors in the foundation of American business. Before the principle announced by the District Court in this case without disturbance from the court below becomes part of the body of law by which business based upon relations of trust may be conducted, this Court should review the matter and pass judgment on the issue involved. Petitioners do not believe that this Court will sanction a relaxation of the heretofore inflexible rule which permits a beneficiary to set aside any transaction by which a fidu-

ciary has diverted to his own use assets or property or profits within the scope of the trust enterprise and rule, as did the District Court in this case, without disturbance by the court below, that a beneficiary has only a qualified right to void such a transaction, depending upon a fine balancing of equities as between the beneficiaries and the wrongdoing fiduciary in accordance as such equities might appeal to the conscience of a particular chancellor in the light of circumstances coincident with the transaction and the general fairness or unfairness of the transaction, "realistically viewed."

4. The court below interpreted a Louisiana statute in a manner which is in conflict with the decisions of the Supreme Court of Louisiana. The court below held that, because the enterprise leasehold interests were recorded in Emlet's name, Cooke could acquire the leaseholds from Emlet unaffected by any equities of petitioners not of record. Underlying the Court's holding in this respect were two erroneous conceptions: (1) that oil leases were "immovables" and regulated by Article 2266 of the Louisiana Code, and (2) the erroneous notion that Cooke did not stand in a fiduciary relationship to petitioners before the transfer of the leaseholds was made.

As to the first proposition, the court below improperly construed the Louisiana Recording Statute (Article 2266) as applicable to leasehold interests.

Article 2266 is by its terms applicable only to immovable property. The leasehold interests involved in the instant case were mineral or oil leases. The Supreme Court of Louisiana rules that a lessee of the usual mineral or gas or oil lease has only a personal right and no real right in or servitude on the leased land, and that as a result such a lease interest is not governed by the rules or subject to the incidents especially applicable to real estate or im-

movables and are not subject to the recording laws, particularly to article 2266.

Gulf Refining Co. v. Glassell et al., 186 La. 190;
Posey v. Fargo, 187 La. 122;
Marchand v. Gulf Refining Co., 187 La. 1002;
Tyson v. Spearman, 190 La. 871.

In a decision by the court below in another case the status of a mineral lease was discussed and also the application of article 2266, and in an opinion by Judge Foster, formerly of the Supreme Bench of Louisiana, concurred in by Judge Hutchison, who wrote the opinion in the present case, and by Judge Holmes, who concurred in the opinion in the present case, it was said:

> "We feel bound to follow latest expression of the Louisiana Supreme Court and we are content to do so."
>
> Sabine Lumber Co. v. Broderick, 88 Fed. (2) 586.

It is difficult to understand why the court below felt in the instant case that it need not follow the decision of the Louisiana Supreme Court, but might reach a different conclusion than was reached by it in the case of Sabine Lumber Company v. Broderick, supra.

At any rate, by undertaking to rule a question of local law contrary to the ruling of the highest court of the local subdivision, the court below violated an undeviating rule established by this Court, namely: That in the interpretation of a state law or statute the federal courts are bound by the rule of decision established by the state court. This same rule was subsequently made applicable to the unwritten law of the state by the considered opinion of this Court in the case of Erie Railroad Company v. Tompkins, 304 U. S. 64, expressly overruling and disapproving the doctrine announced in the old case of Swift v. Tyson. This

Court has repeatedly been compelled to exercise its power of supervision to compel the lower courts to follow the doctrine announced in the Erie v. Tompkins case.

As to the second erroneous notion of the court below and assuming *arguendo* that Cooke was not a member of the joint enterprise, it will not follow that the Louisiana recording statute cut off petitioners' equities in the leaseholds.

Under the undeviating decisions of the Louisiana courts, the recording or similar statutes have not been construed to permit a breach of faith by a fiduciary or the perpetration of a fraud.

Cooke co-operated with Gay, a confidential employee of the enterprise, to perpetrate a fraud upon the members of the enterprise, whereby the actors might profit personally. The laws and decisions of Louisiana expressly recognize the joint liability of wrongdoers who confederate for a wrongful purpose (La. C. C., Art. 2324, 2312, 2311). Article 21 of the Louisiana Civil Code provides that the courts must apply the principles of equity in determining the incidents to a contract. Cited and construed in Byrd v. Meeks (Louisiana Appeals), 156 Southern 193, affirmed 158 So. 70 (not reported in State Reports).

In the case of Jansen v. Bellamore, 147 La. 900, Judge Dawkins, the District Judge in the instant case, then a Judge of the Supreme Court of the State of Louisiana, discussed at length the obligations of coadventurers or quasi-partners to the observance of scrupulous fidelity and fair dealing, consistent with the obligations of trust and confidence, inherent in the relation.

In cases involving fraud or unjust enrichment, the Louisiana courts have without exception gone behind the recording statutes and similar statutes aimed at the pre-

vention of fraud and perjury and permitted fraud to be shown by parol or otherwise notwithstanding such statutes.

Ford v. Parsons, 142 La. 1093;
Rion v. Reeves, 122 La. 650;
Franks v. Davis Lumber Co., 146 La. 803;
Waller v. Colvin, 151 La. 765.

In the case of Texana Refining Company v. Belchic, 150 La. 88, an agent who had received as a bonus from the seller a lease on his own account from persons with whom he was dealing for his principal, was required to account for the lease to his principal. In the last-named case the Louisiana Supreme Court quoted with approval from U. S. v. Carter, 217 U. S. 286, the significant statement that "the disability" of the agent or fiduciary "results not from the subject matter but from the fiduciary character of the one against whom it is applied."

In the case of Succession of Bienvenue, 106 La. 595, the Louisiana Supreme Court said:

> "We take it as settled that a cestui que trust can compel the trustee to convey the property bought for the former if third persons have not acquired any rights against the property."

5. And finally, with respect to the taxation of costs. The court below has ruled in a manner which will inevitably operate to prevent a defrauded beneficiary, or member of a speculative venture such as is involved in this case, from seeking the aid of the courts as against a member of the enterprise who has converted to his own use enterprise assets or operations, and who, having reaped large rewards therefrom, is in a position to defend his possession against other members who are often poor and seldom have a sufficient investment or incentive to justify them incurring the risk of the assessment of heavy costs in the event it ulti-

mately develops that they are unable to prove that the wrongdoer has received benefits in excess of his beneficial expenditures, even though it might clearly appear that the wrongdoer had wrongfully taken over property, and that large sums of money had passed through his hand as a result of such wrongdoing.

The District Court in this case assessed all the costs of the accounting and receivership against the funds seized by the receiver on the ground:

> "In view of the circumstances, however, and especially the failure of Cooke to resort to judicial procedure for the settlement of his relations with Emlet and the other investors, instead of adopting the method which he used, I think the costs of this proceeding should be borne by the estate drawn into the hands of the receiver" (R. p. 353).

The methods referred to are stated in the opinion as follows:

> "The mistake made by Cooke was in not forcing the issue through receivership and liquidation instead of coercing Emlet. In that way, he could have, in competition with his coinvestors and the public, purchased all or a part of the assets" (R. p. 349).

Judge Dawkins' conclusion in that respect is undoubtedly in harmony with the law as it was before the decision of the court below in the instant case. Indeed, by the settled rule of decision, a judicial sale and proceeding was the only manner in which a fiduciary could acquire trust assets and profits therefrom free from an obligation to account and restore.

A fiduciary cannot at will terminate his relationship of trust and deal at arm's length. His obligation of trust continues notwithstanding his attempted withdrawal and even continues after his withdrawal. Restatement of the Law—

Trusts, Sections 337 (d), p. 1022; 340, pp. 1040, 1043, 1044; 342 (g), p. 1057; 243, p. 782.

The same rule is stated in Trice et al. v. Comstock et al., 121 Fed. 620; Meinhard v. Salmon, 249 N. Y. 458; Maas v. Lonstorf, 194 Fed. 577.

> "If the trustee wishes to buy, a bill should be filed and he should apply to a court by motion to let him be a purchaser. 'This is the only way he can protect himself. There are cases in which a court will permit it.' "
>
> * * * * * * *
>
> "The rule has never been relaxed by any court of equity to permit purchases by any other trustee or agent of one who is sui juris."
>
> Michoud v. Girod, 4 How. 503, l. c. 556-8;
> Magruder v. Drury, 235 U. S. 106.

The following quotation from Wormley v. Wormley, 8 Wheat. 421, is peculiarly in point and applicable to the rule announced, in effect, in the several rulings of the court below:

> "Nevertheless, there are canons of the court of equity which have their foundation, not in the actual commission of fraud, but in that hallowed orison, 'lead us not into temptation.'
>
> "One of these is, that a trustee shall not be permitted to mix up his own affairs with those of the cestui que trust. Those who have examined the workings of the human heart, well know that in such cases the party most likely to be imposed upon is the actor himself, if honest; and if otherwise, that the scope for imposition given to human ingenuity, will enable it generally to baffle the utmost subtlety of legal investigations. Hence the fairness or unfairness of the transaction, or the comparison of price and value, is not suffered to enter into the consideration of the court, on these occurrences; but the rule is positive and general, that

the cestui que trust may be restored to his original rights against the trustee, at his option'' (loc. cit. 463).

By ruling as it did, the court below totally ignored the rule that a fiduciary owes a primary obligation to account to a cestui, without regard to whether any sum is in fact owing.

Dillman v. Hastings, 144 U. S. 136.

The standard of duty is no different where the trust to be enforced is constructive than where it is actual.

Buffum v. Peter Barceloux Company, 289 U. S. 227.

The ruling of the court below that the costs ought to be taxed in their entirety against all the petitioners is inconsistent with the admitted facts and with the findings of fact, both of the District Court and of the Master, in that respect and should be ignored by this Court and reversed.

Darlington v. Turner, 202 U. S. 195.

CONCLUSION.

It is, therefore respectfully submitted that this petition for a writ of certiorari should be granted.

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